SANDBERG PHOENIX

BAD FAITH BLOG

Ain't California Great: Defend, Settle Claims as Presented, and Still Confront a Bad Faith Claim

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Fidelity National defended Lehman Commercial in multiple cases and settled approximately $900,000 worth of claims presented, but was unable to defeat Lehman's claim for "bad faith breach" as a matter of law on its motion for summary judgment.

Fidelity National Title Insurance Company issued title insurance policies to Lehman Commercial Paper. Lehman served as an agent for various financial institutions funding a loan for $235,000,000 regarding the purchase of multiple properties. Thereafter, an involuntary bankruptcy petition was filed regarding those multiple properties. Before the bankruptcy petitions were filed, numerous contractors recorded mechanics liens and filed California state court proceedings seeking to foreclose on those liens. When Lehman tendered the defense of the mechanics liens claims, a law firm was retained to defend Lehman (and prosecute claims on Lehman's behalf), all under a reservation of rights. As of the time of the filing of the partial summary judgment motion, Fidelity had paid $900,000 to settle certain mechanics liens claims and paid legal fees and costs of $1.356 million on behalf of Lehman.

Fidelity filed its motion for partial summary judgment seeking to defeat the bad faith claim. Fidelity argued that the bad faith breach claims failed as a matter of law "because Fidelity has been providing 'full policy benefits' by defending Lehman in the underlying litigation and funding settlements." The court began its discussion by citing to the seminal case of *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal.2d 654, 328 P.2d 198 (1958), which held the implied covenant of good faith and fair dealing is found in every contract, including insurance policies. It also recognized a tort remedy which has two elements: "(1) benefits due under the policy must have been withheld; and (2) the reason for withholding benefits must have been unreasonable or without proper cause." *Love v. Fire Ins. Exch.*, 221 Cal.App.3d 1136, 1151, 271 Cal.Rptr. 246 (1990). It was undisputed Fidelity had been defending Lehman and settling claims all along so the only issue was whether that entitled Fidelity to a finding of no liability on the bad faith breach claim as a matter of law. The court noted several key factors in ruling Fidelity was not entitled to prevail as a matter of law.

First, the district court found that it was not necessary for a bad faith breach claim to "be predicated upon a breach of the insurance contract" declaring the proposition "is erroneous as a matter of California substantive law… ." Citing the case of *Schwartz v. State Farm Fire & Cas. Co.*, 88 Cal.App.4th 1329, 106 Cal.Rptr.2d 523 (2001), the district judge noted the proposition is "applicable *only* when there is no coverage, and *no potential coverage*, under the policy."

The court stated insurers in California have been held liable for a bad faith breach even when it is indemnifying its insured. *Dalrymple v. United Services Automobile Ass'n.*, 40 Cal.App.4th 497, 46 Cal.Rptr.2d 845 (1995). In *Dalrymple* the trial court had dismissed the breach of contract claim, but allowed the bad faith breach claim to proceed. The *Dalrymple* ruling was affirmed on appeal even though the insurance company had filed a "declaratory relief action" with the appellate court noting that the insurance company could have filed and pursued declaratory relief "for reasons indicating bad faith." For example, there might be a case where an insurance company filed a declaratory judgment action when there was "no proper cause to dispute coverage coupled with an erroneous interpretation of the policy which was 'willfully misguided.'" The district judge noted even an insurance company that has paid the full policy limits "may be liable for breach of the implied covenant, if improper claims handling causes detriment to the insured."

Second, the district court found "indemnification and defense of an insured alone do not foreclose—*as a matter of law*—a claim for bad-faith-breach of an insurance contract." Since that was the ground upon which Fidelity relied, Fidelity could not prevail. Even though it appeared Fidelity was doing everything right, it could not defeat the bad faith breach claim as a matter of law. Accordingly, it had to keep doing everything right plus, at the same time, defend itself against Lehman's bad faith breach claim and other common law and declaratory relief actions.

By Anthony Martin

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